1889

Liability of Subscribers for Stock, Prior to Incorporation

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Thesis.

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Historical.

It is but the natural order of things that man should seek the society of his fellows, from whence springs those mutual rights and obligations which should be respected in every well regulated society.

Whether it is a result of a similarity of pursuit or residence in the same locality they come to feel a common interest, acquire a common property, become subject to common burthens and common duties, acquire a reputation and name, and finally become the objects of political regulation.

It is not a question of how the fact is brought about or what the origin, whether from a subdivision of a country for political convenience, or in consequence of a precancerted plan or from the progressive operation of natural causes; we find them divided into states, counties, cities and towns.

Other communities are variously formed.

in consequence of a similarity of pursuit by many individuals, whether they are collected into one locality or dispersed over different parts of the country; and others are formed the concourse of considerable numbers of men into one place, whence arise cities.

Among the institutions of modern Europe and America, many of them collective bodies of men, under the names of bodies politic bodies corporate or corporations, make a conspicuous figure in legislative and judicial history. At first they were little more than an improvement on the communities which had grown up without attracting any attention and without any positive institution whereby the attention of the community was called to the fact; and for a considerable period the shade which separated the one from the other was so delicate as to require the most careful observer to distinguish.

The early Roman notion of a corporation

was connected with the persons composing it, as the Vestal Virgins, and Gentiles, yet, the Roman Law never regarded a corporation as a person existing in and of itself, but would treat it as such; but later the law recognized the corporate existence as a unit, and to the unit attached the corporate rights, duties and liabilities.

We have no reason to believe that any special authorization from the state was necessary in early times in order to form a corporation, but under the empire, however, a special permission from the state became necessary and reason for this special permit was due to the evils growing out of societies which were formed having political ends in view, to the determent of the government.

The corporations first to be formed, would, in the nature of things, be created for trading purposes. The people of one locality, be it distant or near another, on account of special advantages of soil or climate, could

produce articles that could not or were not produced in another, and necessitated the exchange or the sale of the goods. Thus trade or, and on account of the distance or quantity thus exchanged it would often require the efforts of more than one individual to make a success of the business.

The religious corporations of early Roman times were comparatively few and consequently attracted but little attention until the establishment of Christianity, and the idea of succession or perpetuation of such institutions may have grown out of the religious veneration and perpetuation of the family institution.

The English common law doctrine of corporations was largely borrowed from the civil law, a result of the introduction of Christianity into England. The civil law was taught in all the great schools by professors, who, for the most part were ecclesiastics and it became engrafted, as it were, into the common law

by these clerics, who, in those times were the learned men, and by reason thereof were appointed judges and counselors to the king, in the decision of causes coming before them, they established the civil law, which, established a precedent to be followed in subsequent cases.

In England, corporations came into existence by grant of charter from the king, by act of parliament, or by prescription; but by the common law the exercise of the rights and privileges of corporations, was prohibited in the absence of an enabling act by the legislature, or charter from the crown

Private corporations for commercial and manufacturing purposes have been known as long, at least, as the institution of the civil law, but it is within the past century that they have been diverse and numerous as to embrace nearly if not all the known branches of industry and commerce. The extraordinary advancement

in the arts and sciences, and the wants of men have opened up new fields of industry, the extent of which it is almost impossible for the individual resources and skill to accomplish, that it has become necessary for capital and labor to combine in order to accomplish the ends sought.

Almost within the memory of man the wants and needs of society seldom required such combination of wealth and skill of many individuals and therefore private corporations were few and attracted but little attention of the legislatures and but little studied by the courts; this, then, may be a reason why we find so many special acts of incorporation on the statute books of the New England, Middle and Southern states, and the apparently conflicting decisions of the courts.

Until a comparatively recent period both public and private corporations in England

were created by royal prerogative, and were invested with such powers and privileges as the favored ones might ask, the financial credit of the King or the public good might require, and these were granted as favors and upon extraordinary occasions.

But to day they have become among the greatest means of stable and national prosperity, and without them, that state of national greatness and prosperity, which distinguishes this above all former times, would be but a pittable comparison. to the present. Perhaps it is true that the extraordinary success which has followed the numberless corporations in its own field of usefulness, has had a tendency to lead to the creation of more than was necessary for a healthy growth of commercial enterprises and industries.

This wonderful growth has led to a more careful consideration of the subject;

both in this country and in England, by our legislatures and courts. That great teacher of men experience, has enabled our legislators to more accurately judge what powers should be conferred upon a corporation in order to accomplish a particular object, so that capital may be induced to undertake the enterprise with that feeling of security and certainty necessary in all business enterprises requiring the investment of so large an amount of capital; and on the other hand, to protect the rights of the public and individuals against the encroachment and oppression which is likely to arise from a careless disregard of their duties by long usage, and the success or failure of their undertaking.

Questions relating to the powers, privileges and liabilities of the stockholders, the corporation, and the creditors have been so frequently before the courts for adjudication, and for the construc-

tions of the statute under which they are organized so to administer the law as to secure to them the full enjoyment of the powers and privileges granted them, and to protect the public and individuals against the abuse of those powers, that in reading the numerous cases it, at first sight, seems as if every local court had its own peculiar notion of the construction of the statute in question.

The tendency of Legislation.

The time and attention of the courts were so occupied and such apparently conflicting decisions and a monopoly of trade secured to the corporations to the exclusion of honest competition, and the voice of public opinion has been so strong that many of the later states have incorporated in their constitutions, articles forbidding the granting of corporate powers by special statute. In Atkinson et al v Marietta &c R.R. Co. 15 Ohio St 21, quoting from

the opinion of the court, "It was intended to correct an existing evil, and to inaugurate the policy of placing all corporations of the same kind upon a perfect equality as to all future grant of powers, of making such laws applicable to all parts of the state, and thereby securing the vigilance and attention of its whole representation; and finally, of making all judicial constructions of their powers, or the restrictions imposed upon them, equally applicable to all corporations of the same class". In other states the tendency is the same as indicated by the opinion above cited, as appears in the veto messages of the Hon. David B Hill, governor of New York, which may be found in his public papers of 1887, page 201, which reads as follows, viz;

"Senate bill (not printed) to establish a ferry from Gunnison's ferry in the town of Crown Point, in Essex county, across Lake Champlain". "The provisions of this bill prohibiting any other ferry within a special distance of the ferry proposed to be established, are clearly in violation of section

18 of Article III of the constitution prohibiting the passage of a private or local bill granting to any private association or individual any exclusive privilege, immunity, or franchise whatever. Governor Tilden vetoed a similar bill on this ground in 1875 (see page 20 veto messages of Governor Tilden for that year), and the court of Appeals has since confirmed Governor Tilden's opinion (98 Ny. 150-182). The constitution applies to Essex county, as well as to other parts of the state".

Agreement.

A grant from the legislature is not of itself sufficient to form a corporation; there must of necessity be an agreement between the persons who are to become the members of the corporation; that agreement need not be in any set form of words, but such that the intent to become members of the corporation may be gathered from it. The legislature cannot force the

acceptance of a charter on a body, but the legislature may enact general powers or special acts under which and by virtue thereof, men may join their capital and endeavors to further a common interest, and it may provide the manner of subscribing and the effect of the subscription, also provide what will be necessary in order that the subscribers may exercise the powers and enjoy the privileges of a corporation; but the interpretation of this contract is the bone of contention: The question arise whether it is an executory or an executed contract; revocable or binding, and these questions are solved in view of the facts and circumstances surrounding each case as it arises.

The common law of England as it existed at the time of the adoption of the national and several State constitutions, except so far as it is altered, modified or repealed by those constitutions and the statutes or as inapplicable to the existing order of things, is the law of the land.

At common law it was a crime to assume the powers and privileges of a corporation; it was an usurpation of some of the powers of sovereignty that could be conferred only by act of parliament or grant from the crown. In the United States it is an exercise of sovereignty by which special powers and privileges are conferred, and that can be done only by an act of the legislature. This act together with the by-laws constitute what is known as the charter of the corporation and which is the standard by which acts of omission or commission are are done in furtherance of its plans or prosecution of its enterprise are measured as lawful or unlawful. This agreement which the parties to the enterprise enter into is of vast importance in their relation to each other, to the corporation and creditors of the corporation.

The engagement of a subscriber to a proposed corporation, is subject to the general principles of the law of contracts, in so far as it

needs a consideration to support it, which is generally the counter-engagement on the part of the corporation to give him the stipulated shares of the proportional value agreed upon, in an enterprise faithfully carried out so as to be substantially the same as that described in the subscription paper and any accompanying or referred documents. The obligation to give these shares is concurrent with and gives support to the subscriber's obligation to pay.

First National Bank v Hunford, 29 Ia. 573.
Athol Music Hall Co. v Carey, 116 Mass. 473.
Parker v Northern & R.R. Co., 33 Mich 23.
Ashuelot Boot Co. v Hoit, 56 N.H. 431.
Johnston v Erwin Female University 35 Ala. 515.

Liability on Subscriptions made prior to Incorporation.

The liability of subscribers signing the articles of agreement prior to incorporation as stated

by Angell & Ames on Corporations § 523, "a person subscribing [to] the organization of a proposed incorporated joint stock company, raises a matter [of] in his contract which will render him liable to the company after incorporation. A subscriber or partner in an undertaking, and willing an agreement to take measures to carry out the same, cannot discharge his liability, or relieve himself of the consequences which he may have thereby incurred himself; and if an act of the legislature has been passed for effecting the purpose of the undertaking, by which certain obligations are created, such original subscriber is not exonerated from his liabilities incurred by the act, by having during the progress of the bill, renounced all further connection with the undertaking, and desired that his name might be discharged from the act." We think that the principle as stated is not [illegible]

in some of the states, although we find some of the decisions in conflict with the rule as laid down and above quoted.

Whether under general or special acts the rule holds good, if the provisions of the statute have been substantially complied with. In Hughes v Antietam Manufacturing Co., 34 Md. 316, Hughes, the defendant signed a preliminary agreement, for the purpose of becoming a stockholder, by which he agreed to take fifty shares of stock amounting to $5000, after the incorporation of the company he refused to pay for the stock for which he subscribed, claiming that the certificate was defective in many essential particulars, to wit: that it was not acknowledged by all of the subscribers; that the amount of its capital stock was not stated with sufficient precision and accuracy. (The capital stock was fixed at $1,500,000., at $100. per share, but the recorded certificate [illegible] shares at $67.50):

that the plaintiff's trade was not sufficiently designated &c. To which objections the court said, "These objections seem to be somewhat technical than sound. The policy of the law, as plainly indicated by the several provisions of the general corporation act, is to encourage the formation of these and other life companies, in order that not only the assured may have the advantage, and proof of a safe financial combined capital and labor; and whilst the requirements of the law are to be fairly and substantially complied with, the rights and franchises of corporations and the interests of stockholders are not to be frittered away by technicalities nor sacrificed to a strained construction of the statute".

In Stanton v Wilson, 2 Hill 153 which was an action in assumpsit to recover the amount subscribed for shares of stock in which plaintiff was treasurer &c. The articles were

charter Oct. 18, 1838. The corporate existence dated from January 1, 1841. The defendant signed the articles with other subscribers, engaged to pay for fifty shares at $100 each to the directors or such person or persons as they should appoint. Cowan J. says, "It is true that the company did not come into existence as a corporation till several months after the defendant's subscription purports to have been made", and further, "The contract though dated before, must be considered as taking effect only from the first of January, and though the money was in terms payable to the directors, or such persons as they should appoint, this was no more than a designation of agents to receive sums really due to the corporation," and "In legal effect, then, the contract of defendant was made on the first of January, and was then to pay the corporation the amount subscribed, in such instalments as it should direct.

provided for. This amount then became a debt due to the corporation." The same doctrine has been held in Eastern Plank Road Co. v Vaughan, 14 Wis. 246, in which Selden, J. says, "Where a written contract is made with one party, but is declared upon its face to be made for the benefit of a third party, such (third) party may bring a suit in his own name upon it." Also in Buffalo & R.R. v Gifford, 87 N.Y. 294, Earl, J. delivering the opinion of the court, says, "While the subscription was not valid and binding before the complete formation of the corporation, because there was no party with whom the defendant could contract, yet after the corporation, it accepted the subscription and recognized the defendant as a stockholder and he was liable." These decisions are well supported by the courts in, 17 Ill. 57; 26 Ill. 41; 1 Metc. 565; 34 Me. 366; 40 Me 172; 72 Ill. 397; 110 Ill. 125. It is a well settled proposition that to sustain a contract, and there be a con-

sideration, either an advantage to be enjoyed by the promisor or some advantage or loss incurred by the promisee. In the case of actions brought by religious or charitable corporations on mere subscriptions, it has been held that there is no necessity of a pecuniary benefit to be derived by the subscriber; but in the case of private corporations for gain, the rule is different, as appears in Lake Ontario &c R.R. Co v Mason, 16 N.Y. 451, which was an action to recover on defendants subscription made prior to filing the articles of association in the office of the secretary of state as by law required, the defendant appealed on the grounds, among others, of the rejection and exception to evidence tending to show a revocation of subscription. The court says, "Until the incorporation of the company was perfected, the subscribers had an interest in the operation and performance of which they could not be deprived

ed by the act of the defendant; and after the articles were filed and recorded in the secretary's office, and the corporation had a legal existence, it acquired a vested interest in the defendant's agreement," and "The subscription of the defendant to the articles of association was in effect a contract to pay for and accept the twenty shares of stock," and cites many cases in this state in support of the following proposition, to wit: "The advantages to be derived from being a member of such a company, and the consequent right to participate in the pecuniary dividends, is a positive benefit; and not only the agreement was a valuable advantage to the subscribers, on the organization of the company, the objection of a want of consideration cannot be made with success." The Hamilton and Dennisville Plank Road Co. v Rice, 7 Barb. 157; Stanton v Wilson, 2 Hill 153; Bank v Batchelor, 2 Denio 45; Schenectady &

Plank Road Co v Flatbier, 1 Sum. 102; Barnes v Penine, 2 Ed. 18:

Vermont R R Co v Clayes, 21 Vt. 30, also reported in 1 Amer Ry. Cases 226, [illegible] the statute incorporating plaintiff it was provided that certain persons named "are constituted commissioners to receive subscriptions to the capital stock", and it was further enacted "And every person, at the time of subscribing, shall pay to the commissioners five dollars on each share for which he may subscribe, and each subscriber shall be a member of said company." and it was also enacted that on a certain amount of shares having been subscribed for or when the commissioners deemed proper, they might call a meeting to for completing the organization of said company. The defendant subscribed for fifty shares after the commissioners were authorized to [illegible]

and prior to the incorporation of said company. Instead of paying five dollars cash on each share subscribed he gave his promissory note in these words "On demand, for value received, I promise to pay the Commissioners of the Vermont Central Railroad Company two hundred and fifty dollars." On which note this action is brought. Plea, the general issue. The court said, "By the terms of the charter each subscriber becomes a stockholder and a member of the company; and the interest thereby acquired is a sufficient consideration to support an action for the amount subscribed, against the person subscribing, upon an express promise to pay the subscription." It was claimed on behalf of the defense that the corporation was not in case at the time of making the promise, but the court held that by an

act of the legislature that persons should subscribe for stock become per se a corporation, and that in the eye of the law the corporation was regarded in esse before they have the right to organize. It is the statute that creates the subscribers for stock, a corporation and not their organizing under it, and that for the purposes for which the act was passed, the subscribers became liable.

Although we find decisions holding the contrary, yet we think that before many years have passed they will be distinguished, limited, and finally overruled. We give a few of the leading cases holding the contrary doctrine.

Union Turnpike Co v Jenkins: 1 Caine 381, was an action on a subscription made prior to the full incorporation of the Company: the act under which plain-

fifty two since granted provides, that the
named persons, are appointed to perform
the several duties therein imposed, and on
or before a certain day to pay to one of
and enter into as follows, viz: "We, whose names
are hereunto subscribed, do &c," "promise to
pay to the President, Directors and Company
of the Union Turnpike Road, Limited, five
dollars for every share of stock in the
said company set opposite our re-
spective names &c," and it was further pro-
vided, "and every subscriber shall, at the
time of subscribing, pay into either of said
commissioners the sum of five dollars for
each share so subscribed." By the last
section of the act it is enacted, "That it
shall be lawful for said directors to call
in and demand of and from the stock-
holders respectively, all such sums of mo-
ney by them subscribed, or to be subscribed,
at such time and in such proportions

as they shall see fit, and upon payment of the time of their shares, and of all previous payment made thereon, to the said president, directors and company."

The first objection raised was, that the promise was void for want of consideration and that the ten dollars not being paid at the time of subscription the contract was incomplete and not obligatory on the company and therefore void.

Radcliffe, J., delivered the opinion of the court, said "The interest in the company in selling the share, and the public advantage to be derived from the success of the institution, on the one side, and the expected profits to accrue from the stock, on the other, were sufficient considerations to support the promise". And "by force of the subscription, it must be considered good". That by the last clause of the act, the company had an election of remedies and viz, it

clause in which case they would pass.
That "neither party could rescind without
mutual consent, or a legal cause, to the
other side". Lewis, J. dissenting says
"The subscription and payment are both
essential to the consummation of the contract.
These were contemporaneous acts." "That the
court saw no consideration for the promise,
He then goes on and asks the following
question, and the facts as stated, "could
not the directors with propriety, have re-
fused to consider Mr Jenkins as a stock-
holder, on account of his not having made
the payment required by the act on his sub-
scription?" To which he answers, "I think
they could", and concludes, "No positive ben-
fit, then, accrues from the future enrol-
ments or the company transactions, can
be considered as a consideration for the
promise, and if it could, none such is
stated on the record." His conclusion as

to the right at the company to refuse to recognize Jenkins as a stockholder or not, is not cited, but I cannot ground he intimates in his deduction from the question, but rather from the suggestion in the prevailing opinion, viz: "That neither party could revoke it without mutual consent, or a default on the adverse side". The commissioners were ready and willing to receive the subscription at the time of the subscription, but the defendant failed to pay, they were simply the instruments of the law and their functions were ministerial.

Suppose the defendant brought an action to compell the plaintiff to issue stock subscribed for, would it not be necessary for him to aver in his pleadings that he had performed the conditions concurrent and precedent on his part? I think it would, and

defendant would not be in a position to make good such an averment. The law when he signed the subscription, or was supposed to know, the legislative intendment of his act and can not now be heard on his own default of payment, because that was a requirement made so by act of the legislature.

This case, however was reversed on appeal. Cames Cases in Error 86, Lansing, Chancellor, says, "They were directed to exact from the persons, who were to be admitted members of the corporation, both subscription and payment as a condition precedent to their admission. If they omitted either to subscribe, or to pay, they did not come within the terms of admission." The commissioners were to receive the payment on the subscription, not to exact payment, but on the other hand the subscriber shall pay, when? at the time of subscribing.

If they subscribed, the statute made it obligatory on them to pay; But on the other hand if they paid they would have the right to subscribe and receive the stock and benefits accruing therefrom. By the last clause of the act the plaintiffs had an election of remedies which could be exercised. The criticism made in this case is applicable to the opinion of, L'Hommedieu, Senator, who also wrote an opinion for reversal.

In Strasburg R.R. Co v Echternacht, 21 Pa 220, the agreement signed by the defendant was as follows, "We, the undersigned, agree to take the number of shares of the capital stock of the Strasburg Railroad Company, set opposite to our respective names, the price per share to be $100, provided there be a charter obtained at the next ensuing session of the Legislature of Pennsylvania, granting said company to terminate said road at the east end of the

borough of Strasburg, and connecting with the state road at or near Lemon Place, granting also the said company to all the business connected with said road &c." Defendant signed for five shares, and subsequently, an application was made for a charter which was granted, the provisions of which were in accordance with the terms specified in the above agreement. The court said, "A contract cannot be made by one person alone." "before a promise becomes a binding obligation, it must not only be made to, but must be expressly or impliedly accepted by the party for whose benefit it was meant. The papers before us is no more than a naked expression of the subscriber's intention to purchase certain shares in the capital stock of a company which it was expected would be incorporated by the legislature, besides, it is without any sufficient consideration." This case is distinguished in Shober v Lancaster Co. Bank

Association, 68 Pa St 439. The court following the decision of Lowrie, C.J. in Academy v Robinson, 1 Wright 210. Thompson, C.J. says "The contract is a positive promise to pay certain sums of money to accomplish a specific object" and "In both subscriptions the associates contemplated the procurement of charters of incorporation". In Academy v Robinson, supra, the court held, that if, the corporation when duly organized, became the legal trustee of the funds subscribed and the proper party to call on the subscribers for payment, if the subscriptions were not withdrawn before the act of incorporation and organization. "The duties created by the act of subscription are duties to the association, and the first of them to be performed is the duty of organization, and when it is completed the duty of paying the sum subscribed is a duty to the organization". Thus refusing to follow the decision in Strasburg Tpk v Echternacht. The facts in McClure v

People's Freight Railway Co. 90 Pa St 263, were similar; The plaintiff in error subscribed for stock after the agreement to consolidate, but before the agreement was filed with the secretary as required, and for which subscription the action was brought. The court held the plaintiff in error was liable on the subscription, but distinguished that case from Strasburg &c v Echternacht, supra, but I confess that I am unable to appreciate his reasoning, and conclude that he disapproved if not expressly overruled it.

In Hibernia Turnpike Road v Henderson, 8 Serg & R 218, was similar to that of Union Turnpike Co v Jenkins, supra, except that in this case it was provided by act of the assembly, that the commissioners who were appointed for taking subscriptions, were to receive from subscribers five dollars for each share subscribed, previous to their subscription. It was to recover these

five dollars this action was brought, which defendant did not pay - Plaintiff failed to recover. It would seem, from the opinions of the majority of the court, that any one who by collusion with a ministerial officer might reap the benefit of a profitable undertaking, and repudiate a loosing one, to the injury of the bona fide subscribers and the public, despite the effort to legislate so that stability and confidence may be given to such undertakings. We quote from Gibson J. who says. "all I say is, that permitting the defendant to subscribe against the express directions of the act, was a breach of duty, which renders the contract illegal, and that he can set up the illegality as a defense". In other words, one may take advantage of his own illegal act, although done in the face of an express provision of the legislature. This act of the legislature authorizing commissioners for certain purposes created a corpor-

ation so far as it is necessary for the carrying out the duties assigned them. The dissenting opinion written by Duncan, J. approving the opinion by Radcliff. J. in Union Turnpik Co. v Jenkins, 1 Caine 381, is a most logical and convincing conclusion.

From a review of the cases, we come to the following conclusion:

First. That a person subscribes for stock in a proposed private corporation for gain, where the amount of capital stock, the number of shares, and price or value of each share is set forth or may be gathered from the articles subscribed, the same nothing appearing, a further direction required by the statute, may revoke his subscription at any time prior to, but not after, the actual incorporation of said proposed corporation, by giving written notice to

all the other subscribers.

Second. That where such subscription, and the conditions as to payment if any, are statutory requirements, the person subscribing cannot revoke at any time, and is liable on his subscription.

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